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OFFICE OF THE SECRETARY

December 30, 1999

HAND DELIVERED
Magalie Salas, Esq.
Secretary
Federal Communications Commission
445 12th Street, SW, Room TW-B204
Washington, D.C. 20554

Re: CC Docket No. 96-45
Federal-State Joint Board on Universal Service
and
CC Docket No. 97-160
Forward Looking Mechanism for High Cost
Support for Non-Rural LECS

Dear Ms. Salas:

On behalf of Roseville Telephone Company, transmitted herewith are the original and 11 copies of its Petition for Reconsideration of the <u>Tenth Report and Order</u> in the above-referenced dockets.

Please date stamp and return the additional copy enclosed herewith.

If further information is necessary, please contact me.

Respectfully submitted,

Paul J. Feldman

Paul J. Feldman
Counsel for Roseville Telephone Company

Enclosures

cc: Mr. Greg Gierczak (w/encl.)

Before the
Federal Communications Commission
Washington DC 20554

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Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward Looking Mechanism for High Cost Support for Non-Rural LECS	)	CC Docket No. 97-160
	)	

PETITION FOR RECONSIDERATION

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December 30, 1999

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SUMMARY

Roseville Telephone Company ("Roseville") petitions the Commission for reconsideration of that portion of the Tenth Report & Order in this proceeding that defined "rural telephone company" for the purposes of providing different high-cost support mechanisms for "rural" and "non-rural" local exchange carriers ("LECs)". The definition used by the Commission (Section 3(37) of the Communications Act *i.e.*, companies serving more than 100,000 access lines) improperly places smaller mid-sized carriers in the same category as LECs hundreds of times their size, thus basing high-cost support for such companies on models designed for carriers with substantially greater economies of scale and scope. In addition, the vastly different way that the current Universal Service Fund supports LECs with less than 200,000 access lines in a study area and the phased elimination of hold-harmless support (as proposed in the Ninth Report and Order in this proceeding) will cause significantly greater rate shock to customers of LECs with less than 200,000 access lines in a study area. In light of the harm likely to be caused as a result, and because the definition used by the Commission is not mandated by the Act for use in connection with federal universal service, Roseville urges the Commission to revise that definition in a manner that treats the smaller mid-sized carriers in a manner more similar to the rural LECs. Such a revision should either rely on the definition of "rural carrier" in Section 251(f)(2) of the Communications Act (LEC holding companies serving less than two percent of the Nation's access lines), or should distinguish non-rural LECs as those with more than 200,000 access lines in a study area.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward Looking Mechanism for High Cost Support for Non-Rural LECs	)	CC Docket No. 97-160

PETITION FOR RECONSIDERATION

Roseville Telephone Company ("Roseville") hereby petitions the Commission for reconsideration of that portion of the Tenth Report & Order in the above-captioned proceeding[1] that defined "rural telephone company" for the purposes of providing different high-cost support mechanisms for rural and non-rural local exchange carriers("LECs)". The definition used by the Commission (Section 3(37) of the Communications Act[2] *i.e.*, companies serving more than 100,000 access lines) improperly places smaller mid-sized carriers in the same category as LECs hundreds of times their size, thus basing high-cost support for such companies on models designed for carriers with substantially greater economies of scale and scope. In addition, the vastly different way that the current Universal Service Fund supports LECs with less than 200,000 access lines in a study area and the phased elimination of hold-harmless support (as proposed in the Ninth Report and Order in this proceeding) will cause

[1] FCC 99-304, released November 2, 1999 (hereinafter *"Tenth R & O"*)

[2] 47 U.S.C. Section 153(37).

significantly greater rate shock to customers of LECs with less than 200,000 access lines in a study area. In light of the harm likely to be caused as a result, and because the definition used by the Commission is not mandated by the Act for use in connection with federal universal service, Roseville urges the Commission to revise that definition in a manner that treats the smaller mid-sized carriers in a manner more similar to the rural LECs. Such a revision should either rely on the definition of "rural carrier" in Section 251(f)(2) of the Communications Act, or should distinguish non-rural LECs as those with more than 200,000 access lines in a study area.

I. Introduction

Roseville is an incumbent local exchange carrier ("ILEC") serving subscribers in 83 square miles, with central office locations serving the Roseville and Citrus Heights, California area. Roseville has been providing high quality communications services to its subscribers for over 85 years, and currently serves approximately 128,000 access lines. While Roseville's access line count places it a mere 28,000 access lines above the definition of "rural telephone company", it is among the smallest of the non-rural LECs ("NRLECs"). To the extent that larger companies can use their size to create greater cost savings, Roseville is in fact closer to rural companies than to the giant NRLECs with which Roseville is being categorized, for the purpose of federal high cost support.

As the carrier of last resort for local subscribers, Roseville takes very seriously its obligation to provide high quality local exchange services at a reasonable cost to the end-user. In previous Commission proceedings on universal service, including August

6, 1999 Reply Comments in response to the Notice of Proposed Rulemaking that lead to the *Tenth R & O* ("*Inputs Further Notice*"), Roseville has expressed its deep concern that the use of proxy cost models to establish federal high-cost support allocations could lead to substantial errors when applied to the differing circumstances of each individual carrier, and that such errors could significantly effect the rates that subscribers pay for service. Unfortunately, upon review of the latest version of the Commission's "Synthesis Model" for estimating the forward-looking costs of providing the supported services, Roseville's concern's have been realized: Roseville's federal high- cost support would be reduced to $0 from its current level of approximately $6 million per year. This complete loss of federal support will without doubt create significant pressure to raise rates. Taking into account the current federal interstate support, Roseville's residential customers pay $20.13 per month (including State-mandated surcharges) through rates established by the California PUC. Based upon the results from the Synthesis Model, which reduces the federal high-cost suport to $0, residential rates for Roseville subscribers would increase to over $24 per line.[3]

As was demonstrated in Roseville's Reply Comments, the figure produced by the model is a result of flawed assumptions in the model that do not reflect the reality of the situation in Roseville's service area. But Roseville's focus in this Petition will not be on the specific flaws in the Synthesis Model. Rather, Roseville will focus on the broader problem of applying the Model and new support mechanisms to carriers for which it is

[3] In addition to these rates, residential customers also pay the end-user common line charge of $3.50 per month, which is currently under review and subject to upward pressure.

not appropriate: smaller mid-sized carriers.

II. The Regulatory Distinction for Applying the High-Cost Support Mechanism to Individual Companies Should be Revised to Correct the Huge Differences in Size Among "Non-Rural" Companies.

In the original *Universal Service Report & Order*, the Commission concluded that a flash-cut shift to high-cost support based on a forward-looking methodology was inappropriate for "rural carriers", since such carriers "generally serve fewer subscribers, serve more sparsely populated areas, and do not generally benefit as much from economies of scope and scale." 12 FCC Rcd 8776, 8936 (1997). In the *Inputs Further Notice*, the Commission sought comments on the use of the definition in Section 3(37) of the Act to distinguish between "rural" and "non-rural" companies for the purpose of high-cost support. However, determining the distinction between "rural" and "non-rural" companies before releasing the Synthesis Model (and before companies have had an opportunity to review in detail the impact of that Model on company operation and funding), commits the mistake metaphorically described as "putting the cart before the horse". Had the Commission finalized the Model first, it would have seen that smaller mid-sized carriers such as Roseville have cost structures that clearly do not fit into the parameters of that Model. At that point, the Commission could have revised the definition of "non-rural" companies to appropriately exclude the smaller mid-sized companies. By this Petition, Roseville is asking the Commission to do so now.

Accordingly, in Reply Comments responding to the *Inputs Further Notice*, Roseville expressed its deep concern about applying the same mechanism to all NRLECs if such companies are to be defined as any company with more than 100,000 access lines. Such a regulatory distinction ignores the tremendous diversity in size, and thus economies of scope and scale, among such companies. For example, As reported in USTA's 1999 *Phone Facts*, SBC Communications has over 282 times as many access lines as Roseville (36,165,695 vs. 128,000). Once SBC's merger with Ameritech is complete, the combined company will have over 446 times as many access lines as Roseville.[4]

Roseville went on to note that a proxy model, by its very nature, is an inexact estimate of cost. Some wire center's cost may be overestimated and others may be underestimated. For large NRLECs with hundreds of wire centers, these errors will tend to cancel out, assuming all other aspects of the model and its input are accurate. Roseville, however, has only two wire centers. Accordingly, when the model is applied to a carrier like Roseville and contains an error regarding a wire center, the impact on the carrier is greatly magnified because that wire center constitutes a much greater proportion of Roseville's operations. Accordingly, Roseville suggested that if the Commission utilizes its proxy model for NRLEC high-cost funding, that this be done only for the largest of the NRLECs, and that the goals of the Telecommunications Act of 1996 would be best achieved by treating the smaller NRLECs in a manner more similar to the rural LECs.

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[4] Based on the figures in USTA's Phone Facts 1999, SBC serves 23.48 percent of the Nation's access lines. Once its merger with Ameritech is completed, the consolidated company will serve 34.26 percent of the Nation's access lines. In contrast, Roseville serves only 0.077 percent (seventy seven thousandths of a percent) of the Nation's access lines.

What Roseville and other parties did not (and could not) know at the time comments in response to the *Inputs Further Notice* were filed, was the manner in which the FCC would decide the mechanism by which non-rural carriers would transition from the old to the new mechanism. In the Ninth Report and Order the Commission decided to hold carriers harmless for the amount of universal service support received under current support mechanisms.[5] The Commission indicated that this hold-harmless support would only be transitional. *Id.* Subsequently, the Federal-State Joint Board on Universal Service issued a request for comments on if and/or how the hold-harmless provisions should be phased out. In responsive comments, many parties suggested that the hold-harmless provisions for non-rural carriers be phased out over periods of from one to three years.

Under FCC Rules governing the current Universal Service Fund ("USF"), there are tow schedules for the computation of explicit support for high-cost study areas. For study areas serving over 200,000 customer lines, support is provided for only 10 percent of any costs over 115 percent of the nationwide average cost. For study areas with less than 200,000 lines, however, support is provided for 65 percent of costs over 115 percent of the nationwide average. What this means is that customers of a company serving less than 200,000 lines, under any phase-out scenario for hold-harmless support, will experience an impact and rate shock six and one half times greater than would customers of a similarly situated company serving over 200,000 lines. Since, by definition, "rural" carriers serve less than 200,000 lines, the customer

[5] FCC 99-306 (released November 2, 1999) at para. 78.

impact for both "rural" carriers and "non-rural" carriers serving less than 200,000 lines would be identical, and significantly more severe than for "non-rural" carriers serving over 200,000 lines.

The following chart illustrates this phenomenon. The chart shows three hypothetical companies with identical per-line costs. The only difference between the companies is the number of lines that they serve. Yet notice the different impact of phase-out of support on these companies.

	Company A	**Company B**	**Company C**
Lines	4,500,000	120,000	4,500
Class	"Non-Rural"	"Non-Rural"	"Rural"
Cost/Line*	$35.00	$35.00	$35.00
Nat'l Average*	$25.00	$25.00	$25.00
Difference	$10.00	$10.00	$10.00
USF	$ 1.00	$ 6.50	$ 6.50
Per-Line Per-Year Monthly Impact of 3-Year Phase-Out (Divide USF Line by 3)	**$ 0.33**	**$ 2.16**	**$ 2.16**

*Hypothetical values for illustration purposes. All figures are $/line/month.

Notice that the customer impact for Companies B and C is identical, even though Company B is "non-rural" and Company C is "rural". Also notice the marked difference between the customer impact for Company A versus the impact for customers of Companies B and C.

Unfortunately, the Commission chose to leave in place its prior decision to use of the Section 3(37) definition as the basis for the distinction between NRLECs and

RLECs. *Tenth R & O* at para. 459. Apparently ignoring Roseville's suggestion, the Commission stated that commenters preferred to retain the existing definition "on the grounds that changing the definition at this time could disrupt the settled expectations that they have developed." *Tenth R & O* at para. 459. While Roseville agrees that expectations regarding funding should not be unnecessarily altered, in this case, this single statement does not provide sufficient justification for failing to correct a regulatory distinction that lacks a rational basis.

First, the Commission's non-action on this issue completely ignores the huge differences in economies of scale and scope among carriers in the NRLEC category (*i.e.*, that SBC/Ameritech will be 446 times as large as Roseville). Yet, it was because of the impact of these differences that the Joint Board recommended, and the Commission agreed, to make the RLEC/NRLEC distinction for high-cost support in the first place. *See*, *Universal Service Report & Order*, 12 FCC Rcd at 8936. While it was correct to try to make a regulatory distinction, the 100,000 line distinction resulting from the use of Section 3(37) is clearly the wrong place to draw the line. Carriers just over that line, such as Roseville and North State Telephone Company, are clearly much closer to rural companies in economies of scale and scope, and in the customer impact of hold-harmless phase-out, than to giant NRLEC BOCs that are hundreds of time larger.[6]

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[6] It should be noted that there are also a number of LECs serving study areas that could easily grow over 100,000 access lines in the next few years. Such companies include ALLTEL, Century Telephone Enterprises, TDS Telecommunications, Horry Telephone Cooperative in South Carolina, Connestoga Telephone Company in Pennsylvania, and the Guam Telephone Authority.

Second, while Roseville sees the logic in looking to the Communications Act for a basis as to where to draw the RLEC/NRLEC distinction, the Commission itself acknowledged that there is no statutory mandate to use the definition in Section 3(37) for the purposes of universal service. *See, Tenth R & O* at para. 459 ("Although the Commission used the rural telephone company definition to distinguish between rural and non-rural carriers for purposes of calculating universal service support, there is no statutory requirement to do so."). Given that there is no statutory requirement to use Section 3(37) for the distinction, Roseville suggests that the Commission reconsider the matter and use a distinction that better accounts for the potential for customer rate shock, as well as the impact of economies of scale and scope. If the Commission believes that a distinction should be based on the Communications Act, then Roseville recommends that the Commission use the distinction made in Section 251(f)(2) for "rural carriers", which are defined as those LEC holding companies serving fewer than two percent of the nation's subscriber lines. Use of the statutory definition of "rural carrier" has the benefit of reflecting an important distinction made by Congress regarding classification of large and small companies. This definition also reflects the huge difference in size between the BOCs and GTE on one hand, and the smaller LECs on the other.[7]

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[7] Of the five BOCs plus GTE, the smallest company is US WEST, which has over 16 million access lines, according to the *1999 Phone Facts.* The next smaller company is ALLTEL, which has 1.9 million lines, and thus would fall under into the two percent category.

If the Commission chooses not to use the two percent definition of "rural carrier" in Section 251 of the Act, then Roseville recommends another alternative that realistically reflects the similarity in customer impact and economies of scope and scale between smaller mid-sized carriers and small rural carriers. Specifically, the Commission should make the distinction between "NRLECs" and "RLECs" be based on service to more or less than 200,000 access lines in a study area, respectively. Use of a distinction that does not directly track a definition of "rural" in the Act reflects the fact that for the purposes of applying different high-cost support mechanisms, the terms "non-rural" and "rural" have little to do with the territory which a LEC serves, and everything to do with its size of the company. While most RLECs are small and most NRLECs are large, the current mechanism used by the Commission to distinguish "RLECs" from "NRLECs" makes no reference to the actual areas served by the carriers, but rather only to the number of lines served by the carrier. Given that the real distinction is between large and small companies, 200,000 access lines is a more appropriate dividing point between large and small LECs for determination of high-cost funding, and transition from the current mechanisms.

As described above, use of 200,000 access lines for the RLEC/NRLEC distinction is also consistent with the way that the current USF treats support for companies with less than 200,000 lines in a study area. Under the USF rules[8], such study areas receive support for only 10% of their cost in excess of 115% of the nationwide average. Study areas with less than 200,000 lines, such as RTC's study

[8] Section 36.631.

area, receive 65% of their cost in excess of 115% from the USF. This is no windfall, however, as state regulators have taken this support into account in the establishment of intrastate rates. What this suggests is that study areas under 200,000 lines typically have very different cost structures and economies of scope and scale than study areas with more than 200,000 lines.

Roseville recognizes that the reason that the Commission did not change the RLEC/NRLEC distinction is that some companies expressed concern about reliance on the current distinction. Yet, the revisions proposed herein should not trigger this concern. First, the revision will only impact a limited number of mid-sized companies: the BOCs and GTE will remain NRLECs, and companies under 100,000 access lines will remain RLECs. If the Commission adopts the two percent distinction, then at most, 13 companies will shift into the RLEC status for the purposes of high-cost support. If the Commission adopts the 200,000 access line approach, then at most five companies shift into the RLEC category. Second, if the RLEC/NRLEC distinction is revised as proposed herein, the affected companies will <u>continue</u> to receive high-cost support in the manner which they <u>currently</u> receive it, until the Commission revises the mechanisms for rural companies. This could hardly be considered a disruption. Furthermore, the Commission's "hold-harmless" provisions will keep the amount of federal high-cost support consistent for a certain period of time, perhaps through the year 2002.

In any case, while the number of companies affected is limited, for those companies and their subscribers, the impact of revising the RLEC/NRLEC distinction will be substantial and important. As was noted above, it is clear to Roseville (and numerous other parties) that the Commission's Synthesis Model is significantly flawed, and does not reflect the real costs faced by companies such as Roseville. The Commission should not ignore the fact that high costs that were identified and funded under the previous rules do not merely go away when they no longer fit in the new model-based mechanism. If Federal support for those costs is eliminated, they will still have to be recovered, either from state funds or from local rate payers.

One apparent reason for the disconnect between the model and reality is that the model is obviously designed to apply to companies much larger than Roseville, with much greater economies of scope and scale. Roseville hopes and suspects that the mechanism designed for rural companies will be more accurate, and thus more appropriate for application to companies like Roseville. The result will be that actual costs will be recovered through appropriate high-cost support, rather than through local rates, thus limiting rate shock.

The Joint Board has created the Rural Task Force ("RTF") to carefully think through the many issues related to applying the high-cost support model developed for the large non-rural LECs to the smaller rural LECs. The recommendation of the RTF is to be submitted nine months following the release of the Commissions decision on the non-rural support mechanism, or September 2, 2000. RTC believes that the public interest, and the interest of customers served by the smallest "non-rural" LECs, will be best served by waiting for the report of the RTF, and applying the rules and policies that result from that recommendation to the universe of small companies and smaller mid-sized companies, as proposed in this Petition.

III. Conclusion

The distinction between RLECs and NRLECs set forth in the *Tenth R & O* improperly places smaller mid-sized carriers in the same category as LECs hundreds of times their size, thus basing high-cost support for such companies on models designed for carriers with substantially greater economies of scale and scope. In light of the harm likely to be caused as a result, and because the definition used by the Commission is not mandated by the Act for use in connection with federal universal service, Roseville urges the Commission to revise that distinction in a manner that treats the smaller mid-sized carriers in a manner more similar to the rural LECs. Such a revision should either rely on the "two percent" definition of "rural carrier" in Section 251(f)(2) of the Communications Act, or should distinguish non-rural LECs as those with more than 200,000 access lines in a study area, as provided in the current rules for USF.

Respectfully submitted,

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